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Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554

CC 97-90

In the Matter of )  
 )  
Requests of U S West Communications, Inc. ) DA No. 97-469  
for Interconnection Cost Adjustment )  
Mechanisms )

RECEIVED

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Office of Secretary

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## SUMMARY

As AT&T and others demonstrated in the Docket No. 96-98 reconsideration proceedings, unless appropriately constrained and structured, “non-recurring” charges pose a serious threat to the emergence of local competition. That is because an incumbent local exchange carrier that is prevented by regulation from overcharging competitors directly for essential inputs can achieve the same artificial cost advantage and the same anticompetitive results indirectly through inflated and discriminatory “one-time” and other non-recurring charges. The Petition and the discriminatory and anticompetitive U S WEST non-recurring charge proposals it challenges once again confirm that the issue of non-recurring charges warrants immediate Commission attention.

The “solution” to the growing non-recurring charge problem is neither complex nor novel. Rather, the Commission can stem incumbent efforts to evade the Commission’s pro-competitive implementation of the Act simply by applying to transactional non-recurring and “one-time competition onset” costs the same familiar and basic economic principles that are the foundation of the Local Competition Order. Those principles mandate a handful of competitively neutral rules to assure compliance with the Act’s nondiscrimination requirements and to minimize the barriers to entry created by non-recurring charges borne by entrants but not incumbents.

With respect to “one-time” costs, those rules should require that: (1) an incumbent’s one-time charges may never exceed amounts determined by spreading those costs across all carriers, including the incumbent, on a proportionate basis, and may be further limited by states as necessary to maintain competitive neutrality; (2) any of an incumbent’s one-time competition onset costs eligible for recovery from entrants must be recovered from all entrants, regardless of entry strategy, in proportion to the number of retail customers they serve in the relevant period;

(3) one-time costs must be amortized over the economic lives of the facilities and systems deployed or modified pursuant to the same economic depreciation principles that apply to other incumbent capital investments; (4) only activities that the owner of an efficient single carrier network would need to undertake to make that network multiple-carrier capable may be considered for inclusion in one-time cost charges; and (5) one-time cost charges must reflect only efficient, forward-looking costs.

The challenged U S WEST one-time cost proposals, which violate each of these basic rules, are discriminatory and anticompetitive on their face. Because the issues raised in this proceeding are of industry wide scope and concern, however, AT&T urges the Commission to address them broadly. Accordingly, AT&T respectfully requests that the Commission act on AT&T's petition for reconsideration in Docket No. 96-98 and establish an efficient, nondiscriminatory and competitively neutral non-recurring charge framework.

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**COMMENTS OF AT&T CORP.**

Pursuant to the Commission's March 4, 1997 Public Notice, AT&T Corp. ("AT&T") hereby submits these comments on the Petition For Declaratory Ruling And Contingent Petition For Preemption ("Petition") filed by Electric Lightwave, Inc., McLeod USA Telecommunications Services, Inc. and Nextlink Communications, L.L.C. (collectively "petitioners").

**INTRODUCTION**

The Petition, and the state commission proceedings it brings to the Commission's attention, starkly confirm that incumbent local exchange carriers' pursuit of massive "one-time" costs shouldered by entrants, but not incumbents, represent a very real and serious threat to local competition and customer choice mandated by the Telecommunications Act of 1996 ("Act") and the Commission's landmark Local Competition Order.<sup>1</sup> The Petition focuses on specific proposals by U S WEST Communications, Inc. ("U S WEST") to saddle potential competitors

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<sup>1</sup> First Report and Order, Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, CC Docket No. 96-98, 11 FCC Rcd. 15499 (released Aug. 8, 1996) ("Local Competition Order").

with “actual network rearrangement costs” that U S WEST claims may approach \$1 billion.<sup>2</sup> Having largely failed in its unabashed efforts to inflate recurring charges with historical, opportunity and other improper costs, U S WEST now seeks to accomplish the same anticompetitive result through inflated and improper “transaction” charges, “bundling” charges, “depreciation reserve defficiency” charges and the “ICAM” charges at issue here.

But U S WEST’s anticompetitive proposals are no isolated event. As AT&T pointed out in the Local Competition Order reconsideration proceeding, such proposals began to surface almost immediately after the Commission adopted its total element long run incremental cost (“TELRIC”) standard for recurring charges.<sup>3</sup> In the intervening six months, as state after state has followed the Commission’s TELRIC lead, that “trickle” of inflated and discriminatory “one-time cost” (and other non-recurring) charge proposals threatens to become a flood. In Section 252 arbitrations, in the permanent rate proceedings that in most states will determine the rates and charges that will apply in arbitrated interconnection agreements, and in special one-time cost proceedings like those initiated by U S WEST, incumbents seeking to capitalize on the existing regulatory vacuum now demand billions of dollars in one-time cost tributes from their potential

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<sup>2</sup> See Petition, App. A at 9 (“Utah ICAM Pet.”); id., App. B at 10 (“Arizona ICAM Pet.”).

<sup>3</sup> See Petition Of AT&T Corp. For Reconsideration And/Or Clarification, CC Docket No. 96-98 at 6-20 (filed Sept. 30, 1996) (“AT&T 96-98 Clarif. Pet.”). See also AT&T Opposition To And Comments On Petitions For Reconsideration And Clarification Of First Report And Order, CC Docket No. 96-98 at 14-17 (filed Oct. 31, 1996) (“AT&T 96-98 Recon. Opp.”); AT&T Reply To Oppositions And Comments To Petitions For Reconsideration And Clarification Of First Report And Order, CC Docket No. 96-98 at 1-12 (filed Nov. 14, 1996) (“AT&T 96-98 Clarif. Reply”).

competitors -- each of which must also separately incur its own "competition onset" costs in transitioning to the new competitive environment.<sup>4</sup>

These non-recurring charge proposals are among the greatest threats to local competition. It is a simple fact that an incumbent that is prevented by regulation from overcharging competitors for essential inputs through recurring charges can achieve the same artificial cost advantage and the same anticompetitive results through inflated and discriminatory one-time and other non-recurring charges. That is because entrants' entry, exit, expansion and contraction decisions reflect all forward-looking costs of doing business, including any non-recurring charges that they may be required to pay. As AT&T cautioned in its Docket No. 96-98 reconsideration petition, it is thus "no exaggeration that such charges -- equivalent in some cases to literally years of TELRIC-based recurring charges -- could prevent the emergence of meaningful competition."<sup>5</sup>

The appropriate response is clear -- the Commission should exercise its undoubted authority (under Section 253 of the Act as well as Section 251)<sup>6</sup> to establish boundaries that fence out patently discriminatory and anticompetitive non-recurring charge practices, and that will aid the states in identifying and preventing other abuses in this largely uncharted territory. It is, of course, critical that the Commission do so before the relevant state commission proceedings --

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<sup>4</sup> For example, as detailed in a recent AT&T ex parte submission in Docket No. 96-98, NYNEX currently seeks recovery from its potential competitors in New York alone of approximately \$140 million in alleged "start-up" costs. See April 2, 1997 Letter from Bruce K. Cox to William F. Caton, Acting Secretary, Federal Communications Commission (attaching copies of the Rebuttal Testimony of Janusz A. Ordover and the Rebuttal Testimony of Kevin Curran, filed on March 19, 1997, on behalf of AT&T with the State of New York Public Service Commission).

<sup>5</sup> AT&T 96-98 Clarif. Pet. at 2-3.

<sup>6</sup> See AT&T 96-98 Clarif. Reply at 3-7.

many of which are already underway -- conclude. Neither new theories nor complex analyses or rules are required to accomplish that task. Rather, as AT&T explained in its 96-98 clarification/reconsideration filings, the Commission can preserve the prospects for emerging competition, without intruding unnecessarily on state authority or denying incumbents a reasonable opportunity to recover efficient one-time competition onset costs, simply by applying to transactional non-recurring and "one-time competition onset" costs the same familiar and basic economic principles that are the foundation of the Local Competition Order.<sup>7</sup>

First, the Commission should make clear that sections 251 and 253 of the Act would be violated if new entrants were forced to bear the entire burden of one-time competition-enhancing investments that benefit all consumers. Effective competition that leads to the most efficient provider winning and serving customers will not occur if new entrants bear a one-time cost "tax" from which incumbents are exempt. Thus, even if one-time costs were incurred only by incumbents, nondiscrimination and competitive neutrality would require that each carrier, including the incumbent, bear a proportionate share of those costs, so that each faces the same cost function and each has an equal opportunity to recover those costs from its customers. In fact, entrants will also incur one-time competition onset costs. Accordingly, the Commission should declare that one-time cost charges may never exceed amounts determined by spreading the

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<sup>7</sup> Because U S WEST's proposal is "limited to one time or start-up extraordinary charges," (Utah ICAM Pet. at 4), AT&T will not here address abuses by U S WEST and others with respect to "transactional" non-recurring costs allegedly incurred in response to entrants' individual requests for services or facilities. There should be no misunderstanding, however, that any non-recurring charge category that is not constrained by efficient, competitively neutral pricing rules can become the vehicle through which incumbents erect roadblocks to competition. Accordingly, it is important that the Commission's rules in this area ultimately address both transactional and one-time recurring charges. See, e.g., AT&T 96-98 Clarif. Pet. at 16-20.

incumbent's costs proportionately across all carriers (including the incumbent), and that states are free to further limit such charges as necessary to assure competitive neutrality.

Second, the Commission should establish a framework to prevent incumbents from manipulating one-time cost charges to discriminate against and disadvantage the entrants or entry vehicles they fear most. In this regard, the Commission should make clear that any "one-time" costs recoverable from entrants must be recovered from each entrant on the basis of relative number of retail customers served, so that incumbents cannot, for example, impede particular entry vehicles by "allocating" a disproportionate share of one-time costs to entrants employing those strategies. Similarly, to assure competitive neutrality between early and later entrants and to prevent incumbents from manipulating the timing of one-time cost charges to stamp out nascent competition, the Commission should require that incumbents amortize any one-time costs that are eligible for recovery over the effective life of the competition-enhancing investments.

Third, the Commission should establish a framework for states to employ in identifying and quantifying the relevant one-time costs. Established forward-looking cost-based pricing principles mandate two basic rules to guard against double recovery and circumvention of TELRIC-based recurring charges: (1) only activities that the owner of an efficient single carrier network would need to undertake to make that network multiple-carrier capable may be considered; and (2) the relevant costs of those activities are efficient, forward-looking costs, not simply whatever the incumbent deems appropriate or ultimately spends.

U S WEST's ICAM proposals, which violate every single one of these basic rules, underscore the immediacy and enormity of the non-recurring cost problem and the need for the Commission to apply its pro-competitive framework in this area. Because these and other non-

recurring charge issues are of industry-wide scope and critical importance, however, AT&T urges the Commission to act promptly on AT&T's Docket No. 96-98 petition for reconsideration and clarification and to adopt a set of efficient, nondiscriminatory and competitively neutral rules to govern all proposed non-recurring charges.

**I. THE COMMISSION SHOULD DECLARE THAT AN INCUMBENT'S CHARGES FOR ONE TIME COSTS MAY NOT EXCEED AMOUNTS DETERMINED BY SPREADING THOSE COSTS ACROSS ALL CARRIERS, INCLUDING THE INCUMBENT, ON THE BASIS OF CUSTOMERS SERVED, AND THAT STATES MAY FURTHER LIMIT SUCH CHARGES AS NECESSARY TO MAINTAIN COMPETITIVE NEUTRALITY.**

Section 253 of the Act, entitled "Removal of Barriers to Entry," authorizes the Commission to invalidate any state requirement that has the "effect" of prohibiting "any entity" from offering "any interstate or intrastate service." 47 U.S.C. § 253 (1996). Economists define a barrier to entry as a cost that must be incurred by a new entrant that incumbents do not (or have not had to) bear.<sup>8</sup> Incumbent proposals, such as U S WEST's ICAM, pursuant to which incumbents would bear none of their one-time costs to comply with the Act and entrants would bear all or a portion of those costs,<sup>9</sup> would thus create classic entry barriers. And, like all "non-recurring" charges that are sunk once made, meaning that they cannot be recovered by an entrant if it decides to exit the market, such one-time cost charges constitute an especially potent entry

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<sup>8</sup> See generally Dennis Carlton & Jeffrey Perloff, Modern Industrial Organization, ch. 4, Harper Collins Publishers (1994).

<sup>9</sup> U S WEST's ICAM petitions, for example, propose a variety of alternative one-time cost schemes "acceptable" to U S WEST. Some contemplate payment only by entrants; others contemplate payment by entrants and end users. The one feature common to each of those alternative proposals is that U S WEST would be the only carrier to bear none of those costs – which explains why U S WEST finds each alternative acceptable. See Utah ICAM Pet. at 6-8.

barrier that clearly would have the effect of prohibiting some potential entrants from offering competing telecommunications services.<sup>10</sup>

Efficient, TELRIC-based pricing, which replicates competitive market pricing outcomes, is a necessary, but not sufficient, condition to effective and undistorted competition. In making entry (and exit) decisions, potential new entrants must consider all forward-looking costs of doing business, not just recurring charges for basic inputs. Consider a potential entrant weighing the prospects of competing against U S WEST in a market in which ICAM is in place. The potential entrant will enter only if it believes that it can do so profitably, that is, only if it will be able to cover the costs of inputs it buys from U S WEST, retailing and related costs and any ICAM and other non-recurring charges it must pay.<sup>11</sup> Although the potential entrant cannot know in advance how much the ICAM charges would be, it does know that whatever amount of ICAM charges it must pay,<sup>12</sup> U S WEST will incur no similar costs. That artificial cost advantage means that U S

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<sup>10</sup> See generally William J. Baumol et al., Contestable Markets and The Theory of Industry Structure, Hartcourt Brace Jovanovich (1982). See also Ordoover Testimony (attached to April 2, 1997 AT&T ex parte) at 14-18.

<sup>11</sup> A new entrant must also consider the unstated, but no less real, costs of doing business with a reluctant monopolist. In this regard, it is by now well documented that a bottleneck monopolist can raise its rivals costs and impede entry and expansion in myriad ways by, for example, "slow-rolling" the provisioning of orders, offering inferior quality service or otherwise discriminating in favor of itself or its affiliates. Unless effectively constrained by regulatory oversight, such anticompetitive activities can greatly increase a potential new entrant's costs and constitute a "hidden" barrier to entry.

<sup>12</sup> Under U S WEST's proposal the final ICAM "true-up" to "actual" costs would not occur for three years. See Utah ICAM Pet. at 8. U S WEST also proposes that one-time costs be split equally among all entrants, see id. at 7, and thus the potential entrant cannot even know what share of those costs it would bear -- if it is the only carrier that enters, it apparently would be stuck with the entire amount.

WEST can profitably sell its services at rates that would mean a loss for the potential entrant.<sup>13</sup> Knowing this, the potential entrant is unlikely to enter. As a result, end users will not necessarily be served by the least cost provider and competition may be stifled altogether.<sup>14</sup>

The only way to avoid such entry barriers is to assure that one-time costs are incurred in a competitively neutral fashion – i.e., that the share of such costs borne by each carrier does not affect significantly any carrier's ability to compete with other carriers for customers in the marketplace. As explained in detail in AT&T's 96-98 clarification/reconsideration proceeding submissions,<sup>15</sup> that solution is not just consistent with the Act's pro-competitive goals, it is mandated by the Act, which: (1) repeatedly states that incumbents must make their essential facilities and services available to entrants on rates and terms that are "just, reasonable, and nondiscriminatory," 47 U.S.C. § 251(c)(3) (emphasis added); see also id. §§ 251(c)(2), 251(c)(4), 251(c)(6), 252(d)(1); and (2) expressly prohibits requirements that "may prohibit or have the effect of prohibiting the ability of any entity to provide any interstate or intrastate

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<sup>13</sup> See Curran Testimony (attached to April 2, 1997 AT&T ex parte) at 7 (noting that proposed NYNEX one-time cost charges "would not only eliminate the 19.1% wholesale discount rate approved by the Commission but would require that a reseller pay 4.20% above NYT's retail rate. A new entrant would lose \$1.33 on every new customer").

<sup>14</sup> See Ordoover Testimony (attached to April 2, 1997 AT&T ex parte) at 17-18; Curran Testimony (attached to April 2, 1997 AT&T ex parte) at 14 ("Like the innkeeper who takes 'here a little cut, there a little slice,' NYT is attempting by its proposed charges for cost onsets and other start up costs to nickel and dime competition to death. While any one of the proposed charges may seem relatively insignificant by itself, in combination, if imposed on NYT's competitors, they will kill competition before it can begin").

<sup>15</sup> See, e.g., AT&T 96-98 Recon. Pet. at 10-15; AT&T 96-98 Recon. Reply at 8-9.

telecommunications service,” id. § 253(a) (emphasis added). See also id. § 253(b) (preserving state authority to impose requirements “on a competitively neutral basis”).

Application of these requirements to the one-time cost problem is straightforward. If only incumbents incur significant one-time costs in implementing the multiple carrier regime mandated by Congress, then those costs should be treated no differently than incumbents’ other one-time capital investments. Under basic TELRIC principles, unit costs of an incumbent’s one-time investments in loops, switches, databases and other network facilities are determined by dividing total forward-looking costs by the total number of units of output that the incumbent is likely to provide to other carriers and to itself. In this way each carrier, including the incumbent, bears a proportion of total costs equivalent to its proportionate use of the network. Accordingly, each faces the same input cost structure, and each has an equivalent opportunity to recover those costs from retail customers.

The same logic compels the conclusion that recovery of an incumbent’s one-time competition onset costs from all carriers, including the incumbent, on a proportionate basis is nondiscriminatory, competitively neutral and allows each carrier, including the incumbent, a reasonable opportunity to recover those costs. It is nondiscriminatory and competitively neutral because each carrier, including the incumbent, bears a portion of one-time costs in each period equal to its percentage share of total customers served multiplied by the total one-time costs eligible for recovery in that period. Thus, although a carrier that serves more customers will bear more one-time costs in absolute terms, it will bear the same one-time cost “charge” per customer as every other carrier. In this way entry, exit, expansion and contraction decisions are not artificially distorted by charges that some carriers bear but others do not, and the incumbent’s

one-time costs do not affect significantly any carrier's ability to compete with other carriers for customers in the marketplace. And precisely because each carrier bears the same charge per customer, an incumbent will have the same opportunity to recover its share of those costs from its customers as every other carrier. A carrier (incumbent or entrant) may elect to absorb those charges or it may elect to pass some or all of them on to the ultimate consumers. How each carrier deals with its share of one-time costs is not important: what is important is that they be imposed on all carriers in a nondiscriminatory manner and that each carrier therefore be given an opportunity to recover them.<sup>16</sup> The Commission should therefore declare that an incumbent's one-time charges may never exceed amounts determined by spreading those costs across all carriers, including the incumbent, on a proportionate basis.<sup>17</sup>

It is also important to recognize that entrants may incur their own one-time competition onset costs -- e.g., to design and implement computer and other systems on their sides of the electronic gateways through which they will communicate with incumbents. If incumbent costs were shared proportionately, incumbents would bear a portion of their one-time costs, but entrants would bear both a portion of the incumbent's costs and all of their own one-time costs. Thus, if the entrants' own costs are significant on a per customer basis -- and, again it is per

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<sup>16</sup> All retail customers will greatly benefit from the new multiple carrier competitive regime and thus all customers, including those that elect to remain customers of incumbents, are beneficiaries of one-time competition onset investments made today to make the new regime possible. That is because all telecommunications customers, whether served by resellers, UNE-based providers, CAPs or incumbents, will benefit from lower prices and better services engendered by competition. Indeed, even U S WEST concedes that the "network rearrangments" that it asks potential competitors to fund will "provide industry-wide opportunity and competition," (Arizona ICAM Pet. at 7), and that those investments will "facilitate [its] existing customers' ability to choose a different local exchange service provider," (Utah ICAM Pet. at 4).

<sup>17</sup> See Ordoover Testimony (attached to April 2, 1997 AT&T ex parte) at 34-47.

customer costs and not absolute costs that will determine the competitive impact -- then requiring entrants to bear even a portion of the incumbent's one-time costs would be discriminatory and could create competition-distorting entry barriers. For that reason, the Commission should also make clear that states are free to further limit incumbent charges as necessary to preserve competitive neutrality. For example, a state applying the Act's nondiscrimination and competitive neutrality principles might determine that incumbent charges should be further reduced or that a "bill and keep" regime, in which each carrier (including the incumbent) bears its own competition onset costs (and, if it chooses, attempts to recover those costs from end users), is appropriate.<sup>18</sup>

Accordingly, the Commission should declare that an incumbent's one-time charges may never exceed amounts determined by spreading those costs across all carriers, including the incumbent, on a proportionate basis, and it should leave the individual states to determine whether competitive neutrality requires further limits on those charges. No other approach is consistent with the language and purposes of the Act.

**II. THE COMMISSION SHOULD DECLARE THAT ANY CHARGES FOR "ONE-TIME" COSTS MUST ALSO BE COMPETITIVELY NEUTRAL AS BETWEEN ENTRANTS AND ENTRY VEHICLES.**

Even if an incumbent is prevented from forcing entrants, as a group, to bear a disproportionate share of one-time costs, standards are necessary to prevent the incumbent from manipulating one-time cost charges to disadvantage particular entrants or entry vehicles that the incumbent may perceive as the greatest threats to its monopoly position. For example, although it

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<sup>18</sup> This latter approach has the virtues of being competitively neutral, easily administered and efficiency-enhancing (because it reduces incentives to overinvest in one-time competition onset costs). See Ordoover Testimony (attached to April 2, 1997 AT&T ex parte) at 40.

concedes that particular one-time investments “may not fall into neat categories” of “resale” costs or “unbundling” costs, (Arizona ICAM Pet. at 6), U S WEST proposes that one-time charges differ for each entry vehicle and that U S WEST determine which costs are assigned to resellers, to users of unbundled network elements, and to facilities-based providers. That approach would give rise to the serious danger that incumbents would attempt to allocate one-time costs in a manner that advantages some entrants (and entry vehicles) and disadvantages others. For example, if an incumbent perceives that it has less to fear in the marketplace from resellers than from UNE-based competitors, it has a strong anticompetitive motive to load an undue share of the overall one-time costs on UNE-based competitors.<sup>19</sup> The Act treats all modes of competition as equally desirable, and incumbents should not be allowed differentially to disadvantage potential competitors. Absent a bright-line prohibition against such strategic misallocations, however, this strategy would be very easy to implement because, as U S WEST’s ICAM petitions make clear, it is unlikely that the costs of electronic gateways and related investments can be directly attributed to any particular entry vehicle. Accordingly, the Commission should declare that any of an incumbent’s one-time competition onset costs eligible for recovery from entrants must be recovered from all entrants in proportion to the number of retail customers they serve in the relevant period.<sup>20</sup>

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<sup>19</sup> See Ordoover Testimony (attached to April 2, 1997 AT&T ex parte) at 41-42.

<sup>20</sup> U S WEST seeks refuge in general “cost causation” theory but ignores the specific real world implications of its proposal. In the real world of imperfect information and incumbent incentives to abuse that uncertainty with strategic misallocations, the only nondiscriminatory course consistent with the Act is for incumbents to treat all recoverable one-time costs as part of a single pool with recovery apportioned on an entry-vehicle-neutral metric such as number of retail customers served.

The Commission should also address incumbent attempts to manipulate the timing of one-time cost charges to disadvantage early entrants. U S WEST, for example, proposes that it be allowed to recover all of its one-time costs during the three year period in which it expects to incur those costs. See Utah ICAM Pet. at 7. That proposal ignores that one-time investments in multiple-carrier capabilities are long-term investments similar to an incumbent's long-term investments in loops and switches. Although loop and switch investments are one-time costs, basic accounting and economic principles dictate that those costs be amortized over the useful lives of the facilities so that today's customers are not forced to subsidize tomorrow's customers. Similar discrimination concerns dictate that one-time competition onset costs also be amortized to ensure that those costs are recovered from present and future beneficiaries of competition, as guided by economic depreciation criteria.

Front-loading of cost burdens on early entrants, by contrast, is consistent with the anti-competitive objective of delaying the onset of competition, and it is fundamentally inconsistent with the pro-competitive goals of the Act.<sup>21</sup> Early entrants are already disadvantaged relative to subsequent waves of entrants. For example, early entrants will face the skepticism of local customers regarding their ability to provide quality local exchange services. And early entrants will be the ones that will test whether UNE-based competition is feasible, there being no precedent for such competition and no tested regulatory procedures to protect UNE-based entrants from competitive abuses by the monopoly owner of the bottleneck. It would turn the Act on its head to disadvantage these early entrants even further by forcing them to bear a disproportionate share of one-time costs, which is precisely what the U S WEST proposal (and

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<sup>21</sup> See Ordoover Testimony (attached to April 2, 1997 AT&T ex parte) at 41-42.

others like it) would do. The Commission should therefore declare that one-time costs must be amortized over the economic lives of the facilities and systems deployed or modified pursuant to the same economic depreciation principles that apply to other capital investments.

**III. THE COMMISSION SHOULD DECLARE THAT THE ONLY “ONE-TIME” COSTS FOR WHICH AN INCUMBENT CAN SEEK RECOVERY ARE FORWARD-LOOKING, INCREMENTAL COSTS THAT AN EFFICIENT INCUMBENT WOULD INCUR TO ACHIEVE THE REQUIRED MULTIPLE-CARRIER CAPABILITIES.**

In addition to establishing the basic framework for competitively neutral recovery of one-time competition onset costs, the Commission should establish the basic framework for determining what types of costs are properly included in the one-time pool and how those costs should be quantified. Otherwise, as U S WEST’s ICAM proposals confirm, incumbents will attempt to use one-time charges as “catch-all” mechanisms through which they can both recover historical, opportunity and other costs properly excluded from recurring charges and double recover costs already included in recurring charges.

The Commission can improve matters in this area and prevent the worst incumbent abuses by clarifying its rules in two respects, consistent with the settled economic principles that the Commission endorsed most recently in the Local Competition Order. First, the Commission should declare that the appropriate baseline for determining the relevant incremental costs is not the incumbent’s existing network or practices, but an efficient network and efficient practices. Thus, with respect to each cost item for which the incumbent seeks recovery eligibility, the Commission should ask whether the activity or investment that generates that cost would be

incurred by an efficient monopoly provider.<sup>22</sup> If the answer is no, the cost should be ineligible for recovery.<sup>23</sup> Otherwise, incumbents will seek to slip into their “one-time cost” charges, whole categories of costs that have no legitimate place in any one-time cost charge. For example, U S WEST seeks to include “costs to expand network capacity in its tandems and interoffice facilities in order to accommodate [entrants’] anticipated traffic demands.” Utah ICAM Pet. at 3. But the relevant forward-looking costs of efficient tandem and interoffice facilities and capacity are properly recovered in recurring network element charges (when entrants serve the end user) and end user charges (when U S WEST serves the end user), and thus U S WEST’s proposal would plainly foster double recovery.<sup>24</sup>

Second, the Commission should make clear that even if the cost is one that an efficient monopoly provider would incur to make its network multiple-carrier capable, the Commission’s rules limit recovery to those amounts an efficient provider would spend for that activity or

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<sup>22</sup> The costs of designing electronic “gateways” and the downstream operations support system and process modifications that will allow competing carriers to have real-time electronic access to the incumbent’s operations support systems, for example, may fall into this category.

<sup>23</sup> Consider a monopoly provider that still employs manual processes in its operations support functions. In order to meet the Act’s requirements, that incumbent must upgrade its systems with new computer functionality and ensure that the upgraded computer systems are multiple-carrier capable. It is only these latter, incremental costs of moving from an efficient monopoly to an efficient multiple-carrier environment that should be eligible for recovery. The “upgrade” costs to reach the efficient monopoly baseline should be wholly ineligible for recovery. It should be noted, however, that even if it does not have electronic systems in place, under TELRIC principles an incumbent would already be compensated for electronic operational support systems through its recurring charges for network elements, which, applying TELRIC, assume efficient, forward-looking electronic facilities and functionalities.

<sup>24</sup> To the extent U S WEST’s claim is that its recurring UNE charges will not cover the specific tandem and interoffice investments it contemplates, those investments are, by definition, unnecessary or necessary only because of U S WEST’s past or present inefficiencies. In either case, efficient pricing rules bar the inclusion of those costs in recurring or non-recurring charges.

investment. Thus, any costs generated by "gold-plating," inefficiency or strategic investments to support broadband or other services should be ineligible for recovery.<sup>25</sup> Incumbents' contrary proposals that they be allowed, for example, to recover "actual network rearrangement costs incurred during the previous year," (Arizona ICAM Pet. at 10), are no more than back door attempts to circumvent the Act's cost standard, the Local Competition Order and state commission arbitration decisions embodying the familiar principle that only efficient, forward-looking incremental costs should be eligible for recovery.<sup>26</sup> To the extent that these charges would be imposed disproportionately on entrants, such proposals are also a recipe for abuse, because incumbents would then have every incentive to maximize these costs and thereby to maximize entry barriers.<sup>27</sup>

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<sup>25</sup> It is well recognized that neither rate-of-return regulation nor price-cap regulation have given incumbents sufficient incentives to operate efficiently. See generally M. Armstrong et al., Regulatory Reform: Economic Analysis and British Experience, ch. 6, The MIT Press (1994); B. Douglas Bernheim & Robert D. Willig, The Scope of Competition in Telecommunications, ch. 4, American Enterprise Institute (Oct. 25, 1996).

<sup>26</sup> See Ordoover Testimony (attached to April 2, 1997 AT&T ex parte) at 22-26.

<sup>27</sup> U S WEST threatens state commissions in its ICAM petitions (as it and other incumbents have frequently threatened the Commission in other contexts) that any failure to cede to its ICAM demands would constitute a "taking" of U S WEST's property in violation of the Constitution. There is no conceivable basis for that claim, and predictably U S WEST provides neither theory nor authority in support of it. As an initial matter, surely even U S WEST would agree that there can be no taking claim if there is no unrecovered cost. And, as demonstrated above, refusing to allow U S WEST to saddle its competitors with all of its one-time costs does not mean that U S WEST will not recover those costs. To the contrary, under the competitively neutral rules proposed in AT&T's 96-98 reconsideration petition, every carrier, including U S WEST would have the same reasonable opportunity to recover its share of one-time competition onset costs from its retail customers. Thus, even if the Constitution did contemplate takings analysis at the "microscopic" level of a public utility's individual investments, U S WEST's claim would never get off the ground. But, of course, the Constitution looks only to total impact on the regulated business as a whole, and even there a regulated utility can make out a takings claim only by demonstrating that the agency has required rates for the utility which are so low that they in fact  
(continued . . .)

## CONCLUSION

For the reasons explained above and in AT&T's 96-98 reconsideration proceeding submissions, the Commission should promptly act on AT&T's petition for reconsideration in Docket No. 96-98 and establish an efficient, nondiscriminatory and competitively neutral non-recurring charge framework. With respect to "one-time" costs, those rules should require that: (1) an incumbent's one-time charges may never exceed amounts determined by spreading those costs across all carriers, including the incumbent, on a proportionate basis, and may be further limited by states as necessary to maintain competitive neutrality; (2) any of an incumbent's one-time competition onset costs eligible for recovery from entrants must be recovered from all entrants, regardless of entry strategy, in proportion to the number of retail customers they serve in the relevant period; (3) one-time costs must be amortized over the economic lives of the facilities and systems deployed or modified, pursuant to the same economic depreciation principles that apply to other incumbent capital investments; (4) only activities that the owner of an efficient single carrier network would need to undertake to make that network multiple-carrier capable may be considered for inclusion in one-time cost charges; and (5) one-time cost charges must reflect only efficient, forward-looking costs.


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(. . . continued)

"jeopardize the financial integrity of the [regulated] companies, either by leaving them insufficient operating capital or by impeding their ability to raise future capital." Duquesne Light Co. v. Barasch, 488 U.S. 299, 312 (1989). See also Jersey Central Power & Light Co. v. FERC, 810 F.2d 1168, 1181 n.3 (D.C. Cir. 1987) (en banc) ("even where the sort of deep financial hardship described in Hope is present, the utility is entitled only to an 'end result' hearing, and is not entitled to any greater return on its investments unless it shows at the hearing both that the rate was unreasonable and that a higher return would not exploit consumers"). And there can be no serious claim that competitively neutral one-time cost recovery rules threaten that sort of deep financial hardship.

Respectfully Submitted,

AT&T CORP.

A handwritten signature in dark ink, appearing to be 'M. Rosenblum', written over a horizontal line.

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April 3, 1997

**CERTIFICATE OF SERVICE**

I, Thomas A. Blaser, do hereby certify that on this 3rd day of April, 1997, I caused a copy of the foregoing Comments of AT&T Corp. to be served upon the parties listed on the attached Service List by U.S. first class mail, postage prepaid.

/s/ Thomas A. Blaser  
**THOMAS A. BLASER**

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